



Indonesia Garment Sector Post-Multi Fibre Agreement

- As of April 2005, Indonesia's textile and garment sector, the country's largest producer of non-oil exports, was holding up well in the early days of the post Multi Fibre Agreement (MFA) quota-less world.
- American and European mid to high-end garment buyers continued to place orders in Indonesia, and some appear to be stepping up their orders in an effort to hedge against safeguards they foresee against China.
- Indonesia's mid to high-end textile products, particularly synthetics, also remain competitive.
- One American buyer claimed that mid to high-end Indonesian garment producers cannot be beat, even by China, for price, quality, compliance, service and vertical integration.
- Small textile and garment companies producing for the domestic market are fairing less well, however. Those that survived the 1998 financial crisis and subsequent capital shortages, are now facing rampant smuggling and a flood of Chinese imports.
- In spite of the relatively bright short-term picture, some exporters are pessimistic about their long-term prospects. They see China moving fast up the value chain while Indonesia moves more slowly to improve its competitiveness.

This report is based on conversations with U.S. and foreign buyers, more than a dozen garment and textile manufacturers, academics, and GOI officials in April 2005 to assess the prospects for Indonesia's textile and garment sector three months after the expiration of MFA quotas. Textiles and garments account for roughly 15 percent of Indonesia's non-oil exports and, directly or indirectly, 3.5 million jobs. The fate of the sector will influence strongly the Government of Indonesia's (GOI) efforts to increase economic growth, find work for some 2 million new seekers annually, and maintain domestic political and economic stability.

Still Hope for Mid and High-End Products

Indonesia has all the ingredients to be one of the winners in the post-MFA world. It has a large, well-established, vertically integrated industry, including mills, garment factories and laundries. It also has cheap and abundant labor, a large domestic market, and a proven capacity to produce quality mid to high-end textiles and garments for export. In spite of a weak business climate and the impending expiration of MFA quotas, Indonesian textile and garment exports grew 3.5 percent in 2004 to US\$ 7.28 billion while employment in the sector remained stable. Garment exports amounted to roughly

US\$ 4.0 billion and textile exports roughly US\$ 3.2 billion. Buyers say that there are no indications so far that mid to high-end U.S. and European buyers are shifting orders out of Indonesia. Instead, they see signs that these same buyers and new ones may be looking to place more orders in Indonesia as a means to hedge against safeguards they expect against China.

One buyer for a major mid to high-end U.S. brand name describes Indonesia as the “world textile and garment sector's best kept secret.” For mid to high-end products, the buyer claimed that Indonesia cannot be beat, even by China, for price, quality, compliance (attention to working conditions and labor rights) and service (flexibility, ability to meet deadlines, and experience with foreign buyers). The buyer describes Indonesia's vertically integrated industry as “icing on the cake.” In spite of continuing security concerns and Indonesia image problems, the buyer's company has been steadily stepping up purchases over the last 10 years.

Other buyer representatives of major brand names sourcing in Indonesia -- GAP, Nike, Levis, Liz Clayborne, Ann Taylor, Tommy Hellfiger, Jones New York and Kellwood -- express similar positive sentiments. However, like many manufacturers, most are concerned about Indonesia's ability to compete in with China and other low-cost producers in the long run. Indonesia's mid to high-end textile manufacturers also remain competitive, particularly in the area of synthetics. Textile exporters tell us that their sales to the U.S. and EU are holding steady and orders from China are increasing. Nevertheless, they too are skeptical about their ability to compete with other major producers like China and India in the long run.

Low-End Domestic Producers Floundering

The situation is less positive for smaller domestic textile and garment companies that produce for the domestic market. Those that managed to survive the 1998 financial crisis are now facing rampant smuggling and a flood of Chinese imports. From 2001 to 2003, domestic production's share of local markets dropped from 79 to 54 percent. Local producers say they simply cannot compete with low-end imports, especially from China, illegal or legal. Ministry of Trade data shows that, in spite of a 2002 Textile Decree forbidding the resale of textile imports locally, legal imports of textiles from China jumped from 340,549 to 675,300 kilograms between 2003 and 2004.

One bright note is that some of Indonesia's small-scale textile manufacturers have apparently cornered the world market on shuttle loom textile products that are sold at a premium in Africa and the Middle East. Indonesia's roughly 15,000 shuttle looms, however, are old and in need of repairs and upgrades.

A Long “To Do” List

Industry experts are seized with the question of what Indonesia's mid to high-end textile and garment producers could do to improve their competitiveness before China's manufacturers improve their capacity to produce higher end products. One Indonesian

garment manufacturer noted that the city of Bandung's local factory outlets -- where middle and upper class Indonesians shop for famous brand names -- are advertising new China import sections.

Garment and textile exporters described a long list of challenges they and the government need to address in the next few years to improve the competitiveness of the industry:

- **U.S. and EU Tariff/Safeguards Policies:** Manufacturers argue that the U.S. and EU should consider preferential tariffs for Indonesia as a means to maintain the country's economic and political stability. At the very least, they called for "the playing field to be kept even" when safeguards are needed (except for China). Market expectations of additional safeguard actions against China may already be encouraging U.S. and European buyers to diversify and purchase more products from Indonesia.
- **Financing:** Manufacturers complained about a credit crunch caused by Bank Indonesia (BI) risk management guidelines for bank lending to sectors with higher than average rates of non-performing loans (NPLs). The textile and garment sectors fall into this category, with estimated NPLs of 8-9 percent in 2004. Manufacturers want banks to consider lending decisions on a company-by-company basis. With greater access to cheap capital, manufacturers say they could upgrade their textile and garment machines, which are now 10 years old on average. New machinery in turn would improve quality and productivity and also enable Indonesia to maintain its competitive edge over China in mid to high-end products.
- **Labor:** The present labor law provides on average nine months severance to dismissed workers, the highest rate in the region. Coupled with provisions against contract workers and outsourcing, such generous severance pay encourages investors to establish factories for less than three years, close them down, and then reopen new factories employing new workers elsewhere. Manufacturers seek more rational calculations for provincial minimum wage rates, with increases linked to inflation. Although not enthused with such reforms, several labor union leaders said they were willing to cooperate with the government and industry to encourage greater investment.
- **Infrastructure:** Across the board improvements in infrastructure will lead to improved productivity, reduced operating expenses, and better service. Many manufacturers say Jakarta's port should be "torn down" and a modern facility built in its place or elsewhere. They complain that the port's inefficiency and unpredictable fees waste considerable time and money. Other manufacturers worry that a lack of investment in Indonesia's power sector will mean that the rolling blackouts across Java become more frequent and disruptive.

- **Corruption:** Manufacturers calculate that various unofficial payments constitute roughly 3 to 4 percent of their operating expenses.
- **Security:** Manufacturers complained that U.S. travel advisory warnings were keeping U.S. buyers away. Those that do business in Indonesia invariably work through agents in Hong Kong and Taiwan, whose reported preference is to source from China and avoid trips to Indonesia. Manufacturers claim that American buyers who do visit Indonesia find the business environment friendly and familiar.
- **Vertical Integration:** Indonesia has all the major components of a vertically integrated industry -- mills, garment factories and laundries. However, the sector has not benefited as much from integration as it could because mid to high-end textile mills produce material largely for export to the U.S., the EU and now increasing for China, while garment manufacturers source the bulk of their material from the U.S. and Europe.
- **Productivity:** Manufacturers and buyers claim that it takes the average Indonesia garment worker twice as long as her Chinese counterpart to produce the same number of garments.

Where Is the Government?

Manufacturers say they need strong GOI commitment and support to the industry to survive. They note that China prioritized textile and garment sectors as critical to the country's employment expansion and economic and political stability. The SBY Administration came into office last fall promising support, but there has been little progress since the tsunami disaster. The new Administration's industrial plan, which is expected to include garments and textiles as a priority sector, is due soon.

At an April 8 Jakarta seminar, International Textile and Clothing Bureau experts declared Indonesia a sure survivor in the post-MFA environment. This contrasts sharply to the deep gloom in Bandung and other garment producing centers late last year as the MFA neared its end. Although the list of concerns and challenges is long, what manufacturers probably need most now is continuing improvements in the business climate and access to cheaper capital. Buyers seem interested in Indonesia as a potential alternative to China, but the garment and textile sectors need new machinery and factories and a lower cost structure to take advantage of them.

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